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IN THE

Supreme Court of the United States

October Term, 1970

~~No. 1780~~ 70-236

Estate of LILLIE MAC MUNN STEWART, Deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITIONER'S SUPPLEMENTAL BRIEF

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IN THE

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Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
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PETITIONER'S SUPPLEMENTAL BRIEF

Statement

This Supplemental Brief is submitted to acquaint this Court of developments since the filing of the Petition. The Amici Curiae, The New York State Bankers Association (Trust Division) and The Corporate Fiduciaries Association of New York City, concur fully in the views expressed herein.

Summary of Argument

On June 9, 1971, the court below decided the *Peoples Trust Company of Bergen County* case (Appendix A) in a way directly and unmistakably in conflict with the

case at bar and with two Fifth Circuit decisions. That the cases are inconsistent is also the government's view. The government so stated in its Petition for Rehearing in *Peoples Trust* (Appendix B).

The government's position in its Petition for Rehearing (denied July 12, 1971) is that deductibility in this series of cases should not turn on state law differences. Petitioner agrees. The government claims that no deduction is allowable in any case in any state if the trustee is given any discretionary powers. Petitioner disagrees. Under this extraordinary claim of the government, which is contrary to its position during the previous forty years of its administration of the estate, gift and income tax laws, no charitable remainder following an income interest in trust would be deductible.

More than 48 docketed cases turn on the issue herein. An unknown number of additional controversies are already at some administrative stage within the Internal Revenue Service, and because of the October 9, 1972 effective date provisions of the 1969 Tax Reform Act for the estates of many decedents, further cases are bound to arise for some years to come.

Because of the squarely conflicting decisions in the circuits, the intrinsic importance of the legal issue involved and the volume of controversies governed by it, this Court should grant the Petition for Certiorari.

ARGUMENT

POINT I

The *Peoples Trust Company of Bergen County* decision of the Court of Appeals for the Third Circuit directly and unmistakably conflicts with its decision in the case at bar and with two decisions in the Fifth Circuit.

Within one week after the filing of the Petition for Certiorari herein, the Court of Appeals for the Third Circuit decided *Peoples Trust Company of Bergen County* v. *United States,* —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,786, 27 Am. Fed. Tax R.2d Para. 147,582 (3d Cir. 6/9/71, rehearing denied 7/12/71), in favor of the taxpayer. The opinion, set forth in Appendix A, squarely conflicts with the case at bar in the same Third Circuit and the decisions of the Court of Appeals for the Fifth Circuit in *Miami Beach First National Bank* v. *United States,* —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,774, 27 Am. Fed. Tax R.2d Para. 147,565 (5th Cir., April 26, 1971) and *First National Bank in Palm Beach* v. *United States,* —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,777, 27 Am. Fed. Tax R.2d Para. 147,570 (5th Cir., May 7, 1971).

With respect to the Fifth Circuit's holdings, the court in the *Peoples Trust Company* case wrote:

> "We are aware that the Fifth Circuit, in two cases arising under Florida law, has accepted much of the position advanced here by the [government] with respect to clauses similar to Article 9. The *Florida Bank at Lakeland* v. *United States,* No. 30,183 (5 Cir. April 26, 1971); *The Miami Beach First National*

Bank v. *United States*, No. 29,524 (5th Cir. April 30, 1971). The trust provisions in those cases are different than here, and the law of Florida, as set forth in those opinions, apparently differs from that of New Jersey." 71-1 U.S. Tax Cas. Para. 12,786 at 9055-5, 27 Am. Fed. Tax R.2d Para. 147,582 at 148,643-44, Appendix A at 12a.

Pointing to *unstated* differences in the governing instruments and "apparently" different bodies of local law does not distinguish the cases; it simply emphasizes the chaotic state of the law. Taxpayers in essentially the same positions are being treated differently, and the courts are not successfully developing a rule of law to explain—let alone justify—the unequal treatment.

Chaos will be the rule just as long as the federal judiciary, inexperienced in the field, vainly tries to evaluate entire bodies of local trust law in relation to particular trust provisions to see if they "provide any fixed and ascertainable standard of investment and management conduct for the trustee." *Estate of Stewart* v. *Commissioner*, 436 F.2d 1281, 1288 (3d Cir., 1971), Petitioner's Brief, Appendix B at 3a. No such "fixed and ascertainable standard" exists in the trust law of any state. Trust law is founded on and derives its strength from the opposite concept—giving the trustee wide discretion and then holding him accountable for its proper exercise. Preservation of the respective interests of the beneficiaries accordingly does not depend on "fixed and ascertainable" rules or standards. Under trust law everywhere, a trustee must exercise *all* his powers, both investment and administrative, impartially as between principal and income beneficiaries unless the governing instrument ev-

idences a different intent.[1] The trustee has wide discretion, particularly in investing, to determine precisely how the balance among the beneficiaries is to be maintained overall. See Brief of Amici Curiae, pp. 14-16. Abuses of such discretion are reviewable and correctible by the courts. But basically, the trust system places its reliance on the good faith of men required to be disinterested and sworn to be impartial to exercise fairly the discretions entrusted to them.

POINT II

The government's position in its most recent statement concerning the legal issue in this case is that deductibility should not turn on state law differences. Petitioner agrees. The government asserts that no deduction is allowable in any state if the trustee is given any discretionary powers. Under this extraordinary claim, which contradicts the Service's own construction of the statute for 40 years, no charitable remainder following an income interest in trust is deductible.

In the *Peoples Trust Company* case, the Court of Appeals for the Third Circuit distinguished the case at bar in the following terms:

> "[Taxpayer's] first contention, that we should look only at dispositive and not at administrative provi-

[1] A different intent is quite apparent in the will in *Rand* v. *United States*, —— F.2d ——, 71-2 U.S. Tax Cas. Para. 12,797, 2 Am.Fed. Tax R.2d Para. — (2d Cir. 7/22/71) (Vermont law—held for government). The income beneficiary was given the "entire gross or net income" of the trust estate, a provision which constitutes an extreme deviation from established concepts of what constitutes principal and income, and in effect directs that principal in indeterminate amounts be diverted to the income beneficiary. Cf. *Florida National Bank at Lakeland* v. *United States*, —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,771, 27 Am. Fed. Tax R.2d Para. 147,568 (5th Cir. 1971), discussed on p. 20 of the Brief of Amici Curiae herein.

sions, is foreclosed by this court's decision in *Estate of Stewart* v. *Commissioner,* No. 18,947 (3 Cir., Jan. 5, 1971). There we held that administrative powers could give a trustee such broad discretion to select investments and to allocate receipts between income and corpus that the charitable remainder would become unascertainable. The *Stewart* trust instrument was governed by New York law, which we held did not impose any fixed and ascertainable standard to control the conduct of the trustee under its broad language. If in the instant case the trust instrument, construed as it would be in New Jersey, vested the trustee with powers to make significant diversions from corpus, and if that power were no way limited by the New Jersey law, the *Stewart* case would control." 71-7 U.S. Tax Cas. Para. 12,786 at 9055-3, 27 Am. Fed. Tax R.2d Para. 147,582 at 148,641, Appendix A at 5a.

* * *

"Both the provisions of the trust instrument and the law of New Jersey present quite a different situation with respect to the trustee's powers than was presented in *Estate of Stewart* v. *Commissioner, supra.* Because there is not in this trust, as it would be construed in New Jersey, a power to divert the ascertainable corpus from its charitable purpose, Section 20.2055-2(b), the deduction should have been allowed. The judgment of the district court will be affirmed." 71-1 U.S. Tax Cas. Para. 12,786 at 9055-5, 27 Am. Fed. Tax R.2d Para. 147,582 at 148,644, Appendix A at 12a.

The government's Petition for Rehearing, also appended (Appendix B), which was denied by the court on July 12, 1971, pointed out that there is no significant difference

between the laws of New York and New Jersey relevant to the proper application of section 2055:

> "We submit that if New York's fiduciary law did not limit the *Stewart* trustee's invasionary powers so as to satisfy the requirements of Section 2055, New Jersey law must equally be insufficient to satisfy the requirements of that section. The laws of these two states are based upon essentially the same equitable principles. Thus, while New York trustees must satisfy New York courts that exercises of discretion were 'prudent' (*Estate of Stewart* v. *Commissioner, supra,* p. 1288; *In re Talbot's Will,* 170 Misc. 138, 9 N.Y.S. 2d 806 (Surr., 1939)), New Jersey trustees are, at most, bound by the no more demanding standard of proving their discretionary powers were exercised 'within the bounds of a reasonable judgment.' [Appendix A at 10a.] *Russell* v. *Princeton Laboratories, Inc.,* 50 N.J. 30, 38, 231 Atl. 2d 800, 805 (1967). The decedent here, as did the decedent in *Stewart,* conferred discretionary powers upon her trustee. The New Jersey courts, of course, retain the ultimate power to intervene should a trustee abuse the discretion granted it, but the measure of deviation from normal trust practice required to establish an abuse of discretion is, in New Jersey as well as in New York, substantial. Compare, *Swetland* v. *Swetland,* 100 N.J. Eq. 196, 134 Atl. 822 (Ch., 1926), with *In re Estate of Davis,* 54 Misc. 2d 1065, 284 N.Y.S. 2d 414 (Surr. Ct. 1967); see also III Scott, *Trusts,* § 187 (1967). (See our main brief, pp. 14-16). To be sure, there is some outer limit beyond which the trustee here cannot go without encountering judicial intervention. *Pennsylvania Co., Inc.* v. *Gillmore,* 137 N.J. Eq. 51, 43 A.2d 667 (Ch., 1945) (change of investments which would reduce life

> beneficiaries' income by over 21 to 68 percent not permissible). But, as the *Stewart* court clearly held, the protections afforded by the potential of state court intervention is alone insufficient to 'guarantee preservation of any predictable fraction of corpus for disposition' to the charitable remaindermen. *Henselee* v. *Union Planters Bank, supra,* pp. 598-599, fn. 3. The mere fact that the two trustees may be held accountable to courts of different states, provides no adequate basis for the difference in outcome when these courts apply the same standards to review exercises of discretionary powers." Appendix B at 19a-20a. [Footnote omitted.]

Thus, the government asserts entitlement to taxes on remainders given to charity in every state whenever the decedent has "conferred discretionary powers" on the trustees. It is to adjudicate the merits of this extraordinary claim that this Court should grant the petition herein.

For if the government is right, no remainder interest in any charitable remainder income trust and no capital gains allocated to principal during the administration of such a trust are deductible. Every settlor necessarily confers broad discretionary powers on his trustee when authorizing him to invest and reinvest the trust estate. See Brief of Amici Curiae at pp. 13 (for the capital gains point) and 14-16 (for the investment point).

The government asserts that this Court's holdings in *Henslee* v. *Union Planters Bank,* 335 U.S. 595 (1949) and *Merchants Bank* v. *Commissioner,* 320 U.S. 256 (1943) are authority for its position. Appellant's Petition for Rehearing *Peoples Trust Company of Bergen County* v. *United States,* Appendix B at 15a. Only a pronouncement by this Court to that effect could induce belief. If such is

the law, the thousands of fiduciaries now administering trusts in the United States and their charitable beneficiaries are entitled to know it so that they may at least petition Congress for relief.[2] If this new concept is the law, it should in any event no longer be applied on the catch-as-catch-can basis employed by the government since 1960, but equally to all trusts whose trustees have any investment or other discretionary powers.

At the root of this case is a rejection by the Internal Revenue Service of the trust method of managing property as being insufficiently protective of the interests of the charitable beneficiaries. Those of us who have studied the centuries of evolution of the trust concept, and witnessed the single-mindedness of generation after generation of judges, lawyers and legislators to make the trust ever more fair, effective and responsive to changing needs for the good of all beneficiaries, must surmise either that the Service is not equally aware of this history or, as is more likely, that it is concerned (as a tax collector may be expected to be) more with thwarting the one in a thousand tax avoidance case involving a faithless trustee than with the overall benefit to charity in the entire run of the thousand cases.

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[2] During the legislative preliminaries to the enactment of the Tax Reform Act of 1969, Congress certainly did not believe that the government's position herein was the law. The following statement appears in both H.R. Rep. No. 94-413 (Part 1), 91st Cong., 1st Sess. 58 (1969) and Sen. Rep. No. 91-552, 91st Cong., 1st Sess. 86 (1969):

> "Present law.—Under present law, an individual may make an indirect charitable contribution by transferring property to a trust and providing that the income is to be paid to private persons for a period of time with the remainder to go to a charity. A charitable contributions deduction generally is available for the remainder interest given to charity. The amount of the deduction is based on the present value of the remainder interest which is determined by using actuarial life expectancy tables and an assumed interest rate."

The Internal Revenue Service now believes that only mathematical formulations, such as the fixed and variable annuities of the charitable remainder trusts it persuaded Congress to adopt in 1969, adequately protect the interests of a charitable remainderman as against income. But until 1960, when it made the unannounced change in its 40 year old interpretation of the law described on pages 4-5 of the Brief of Amici Curiae herein, it too accepted as sufficient the degree of protection provided by the trust system. Whatever may be the merits of the Service's new belief, the government is not entitled to non-uniform, retroactive application of it to the detriment of settlors like Mrs. Stewart, who made their gifts in all good faith, and their intended charitable beneficiaries.

POINT III

As of May 1971, there were at least 48 docketed cases throughout the country involving the issue herein, involving many millions of dollars in taxes. Many other cases are now at some administrative stage in the Internal Revenue Service.

After the Petition herein was filed, we learned that there were at least 48 docketed cases involving the issue herein with many millions of dollars in taxes at stake, as of May 1971. These are set forth in a list kept by the Office of the Chief Counsel of the Internal Revenue Service. A copy of this list is set forth in Appendix C. It is not complete. For example, *Greer* v. *United States*, 70-1 U.S. Tax Cas. Para. 12,690, 25 Am. Fed. Tax R.2d, 70-1629 (M.D.N.C., 1970), which we now understand[3] has been appealed to and argued in the Court of Appeals for

[3] At page 10 of the Brief of *Amici Curiae*, it is stated erroneously that the government did not appeal in this case.

the Fourth Circuit, is not listed. Moreover, the listing does not purport to include cases we have heard of still being considered at some administrative level within the Internal Revenue Service itself.

POINT IV

Because of the squarely conflicting decisions in the circuits, the intrinsic importance of the legal issue involved and the volume of controversies governed by it, this Court should grant the Petition for Certiorari.

Respectfully submitted,

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Appendix A

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 19,032

PEOPLES TRUST COMPANY OF BERGEN COUNTY,
EXECUTOR OF THE ESTATE OF DORA PLUME, *Deceased*

v.

UNITED STATES OF AMERICA,

Appellant

(D. C. Civil Action No. 947-67)

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Argued April 5, 1971

Before GANEY, VAN DUSEN and GIBBONS, *Circuit Judges*

Opinion of the Court

(Filed June 9, 1971)

GIBBONS, *Circuit Judge.*

The United States appeals from a judgment of the district court in favor of a taxpayer in an action for a refund. The plaintiff-taxpayer is the corporate executor of the estate of Dora Plume. Dora Plume died on May 5, 1964, survived by her husband. Her executor filed an estate tax return claiming a charitable deduction of $273,231.99, which

it claimed was the value of a charitable remainder in an *inter vivos* trust which Dora Plume had executed on June 9, 1960. Her will poured her residuary estate into this trust. The Commissioner of Internal Revenue disallowed the claimed charitable deduction and assessed a deficiency in estate tax of $54,207.03, plus interest. The taxpayer paid the deficiency, filed timely refund claims for tax and interest and brought suit for a refund. The United States moved for summary judgment, which was denied, and the district court entered summary judgment in favor of the plaintiff.[1]

The June 9, 1960, *inter vivos* trust named the settlor as trustee for life and reserved to her a life income. It provided, for purposes herein relevant, that upon her death the successor trustee should pay the income to settlor's husband for his life, and upon his death should pay the corpus to certain named charities, each of which qualifies as a charitable recipient under Section 2055 of the Internal Revenue Code of 1954. 26 U.S.C. §2055 (1964). The trust instrument provided that the trustee could pay or expend for the benefit of her husband "such part or parts or all of the principal of the Trust Estate as it shall judge to be necessary, in its discretion, to provide adequately for the said husband of the Settlor and for his support, maintenance, health and needs."

The United States contends that the value of the charitable remainder is unascertainable and hence not deductible[2] because of certain administrative provisions in the trust instrument which would permit the trustee to divert the

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[1] The opinion of the district court is unreported.

[2] The Treasury Regulations allow a deduction from a decedent's gross estate of the value of a charitable remainder interest only if such interest is presently ascertainable. Treas. Reg. §20.2055-2 (1958).

corpus of the charitable remainder to the non-charitable life beneficiary. These administrative provisions are:

> "[Article] 9. Capital gain dividends derived from mutual fund investments shall be considered to be income and shall be paid to the then income beneficiary in the same manner as general income of the Trust Estate.
>
> "[Article] 10. In addition to all other powers granted to the Trustee by law, the Trustee shall have the following specific powers:
>
> * * *
>
> 13. To retain, sell, invest and reinvest any or all of the Trust Estate in any real estate, mortgages, stocks, bonds or securities of recognized investment rating, which the Trustee in her discretion shall deem wise, necessary or expedient, not necessarily confining herself to legal investments.
>
> * * *
>
> F. To do all acts which the Trustee shall deem advisable without seeking the aid of any court, even though such act may not be appropriate for fiduciaries under any statutory or other rule of law or court, but for this power."

The appellant does not contend in this appeal that the dispositive provisions of the trust, including the power to invade corpus to provide adequately for the support, maintenance, health and needs of the decedent settlor's husband, render the charitable remainder unascertainable.[3]

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[3] See *Ithaca Trust Co.* v. *United States*, 279 U.S. 151 (1929). *Cf. Henslee* v. *Union Planters National Bank Trust Co.*, 335 U.S. 595 (1949); *Merchants Bank* v. *Commissioner*, 320 U.S. 256 (1943); *Peoples Trust Company of Bergen County* v. *United States*, 412 F.2d 1156 (3 Cir. 1969); *Zentmayer's Estate* v. *Commissioner*, 336 F.2d 488 (3 Cir. 1964).

Rather, it contends that the administrative power to invest in mutual funds coupled with the administrative direction that mutual fund capital gains distributions shall be treated as income gives to the trustee the uncontrolled power to divert corpus from the remainder interest to the life interest. This occurs, appellant urges, because the shareholder of a mutual fund owns a proportionate interest in the fund's undivided aggregate assets. What he pays for his share is determined by that asset value on the date of purchase. That price reflects unrealized capital appreciation of the fund holdings. When the fund subsequently realizes gain on such appreciation and distributes all or part of the realized gain the effect is a partial return of the purchase price which, if treated as income, depletes corpus.

In an economic sense there is no distinction between the purchase of stock in any corporation having appreciated but unsold assets and the purchase of stock in a mutual fund having such assets. If in the former case the corporation should realize on the appreciated asset, that realization, net after payment of the capital gains tax, would be added to earned surplus and would be available for dividends. N.J. Rev. Stat. § 14A:7-14 (1969); *National Newark & Essex Banking Co.* v. *Durant Motor Co.*, 124 N.J. Eq. 213, 1 A.2d 316 (Ch. 1938), *aff'd* 125 N.J. Eq. 435, 5 A.2d 767 (E. & A. 1939). Such dividends, received as trust income, would theoretically have the same effect on trust corpus as capital gains distributions. Indeed the purchase price of stock of any corporation may at any given time reflect earnings which have not yet been but may in the future be declared as dividends. To the extent that such earned income is reflected in the purchase price the same theoretical effect on corpus occurs when a dividend is later declared and re-

ceived as trust income. The appellant does not contend that either possibility makes a charitable remainder unascertainable. Rather, it contends that capital gains distributions of mutual funds present a unique problem because under the governing provisions of the Internal Revenue Code there is a strong incentive on the part of fund managers to pay out rather than reinvest realized capital gains.[4] Thus, the appellant argues, investment in mutual funds and the treatment as income of capital gain distributions from such funds, presents to the trustee a unique opportunity to increase distributions to a life beneficiary at the expense of a remainderman.

In response appellee contends, (1) that the court should continue to recognize the distinction, for the purpose of determining the ascertainability of a charitable remainder, between dispositive and administrative provisions in a trust instrument; (2) that the trust instrument reflects no intention on the part of the decedent settlor to favor the life beneficiary over the charitable remainderman; and (3) that the New Jersey law applicable to the trust provides sufficient control over a trustee's exercise of discretion that the possibility of the diversions conjured up by the appellant does not really exist.

Appellee's first contention, that we should look only at dispositive and not at administrative provisions, is foreclosed by this court's decision in *Estate of Stewart* v. *Commissioner*, No. 18,947 (3 Cir., Jan. 5, 1971). There we held that administrative powers could give a trustee such broad discretion to select investments and to allocate receipts

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[4] To the extent that a regulated investment company distributes capital gains income it thereby avoids corporate tax liability and passes on to its shareholders advantageously taxed long term capital gains. 26 U.S.C. §852(b)(3) (1964).

between income and corpus that the charitable remainder would become unascertainable. The *Stewart* trust instrument was governed by New York law, which we held did not impose any fixed and ascertainable standard to control the conduct of the trustee under its broad language. If in the instant case the trust instrument, construed as it would be in New Jersey, vested the trustee with powers to make significant diversions from corpus, and if that power were no way limited by the New Jersey law, the *Stewart* case would control.

It was formerly the position of the Commissioner that a charitable remainder was ascertainable whether or not the dividends representing realized capital gains of mutual funds are distributed as income to the life beneficiary or added to the corpus. Rev. Rul. 55-620, 1955-2 Cum. Bull. 56. In 1960 the Commissioner changed his position, revoking Revenue Ruling 55-620. His new position was that if the trust instrument provided or the applicable law permitted the treatment of mutual fund capital gains distributions as income payable to the life beneficiary the remainder became unascertainable. Rev. Rul. 60-385, 1960-2 Cum. Bull. 77.

At the time the trust instrument was executed, Revenue Ruling 55-620 was in effect. The decedent and her husband, in the spring of 1960, discussed with their attorney an estate plan whereby each of them would create *inter vivos* trusts leaving a life estate to the other, then to their only child, and the corpus to charitable remaindermen. The details were left to the scrivener, and there was no discussion of the provision with respect to mutual fund capital gain dividends. That provision was a standard administrative clause then in general use in that attorney's office. Decedent and her husband each had separate

estates ample for their respective needs in the modest manner in which they lived. Their daughter predeceased them.

The decedent's trust remained revocable until her death. Before her death, while she was ill, on April 21, 1964, the settlor amended the trust to name the present corporate trustee. Between January 1, 1961, the effective date of Revenue Ruling 60-385, and the date of her death, the decedent could have but did not change the provisions of the trust to conform to the Commissioner's new position. The provisions of Revenue Ruling 60-385 were not called to her attention. Since the Commissioner's new position never came to her attention no inference can be drawn respecting her dispositive intention from her failure to make a change. Revenue Ruling 60-385 is not binding as a statute or regulation. *United States* v. *Bennett*, 186 F.2d 407 (5 Cir. 1951); *Aluminum Co. of America* v. *United States*, 123 F.2d 615 (3 Cir. 1941).

The applicable Treasury Regulation, Section 20.2055-2(b) provides in part:

> "If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power."

Subsection (a) of the same regulation provides that a charitable remainder is deductible only insofar as presently ascertainable, and refers to the method of calculation of present value. There is no question that the value

of the charitable remainder was, at the time of decedent's death, ascertainable by reference to her husband's life expectancy and likely needs. The language of the Regulation quoted above is in subsection (b), captioned "Transfers subject to a condition or a power." Under the Regulation, then, the issue is whether the trustee has a power to divert corpus from the charities to the life tenant. It is not whether as a result of the trustee's investment policies the trust corpus will at the end of the life estate be greater or less than when it vested. That risk is inherent in any trust arrangement which postpones distribution, and it does not for purposes of the deduction make a charitable remainder unascertainable. *Gardiner* v. *United States*, 69-2 USTC ¶12.628 (D. Ariz. 1969); *Estate of Phyllis W. McGillicuddy*, 54 T.C. 315 (1970); *William T. Grant*, 48 T.C. 606 (1967).

We must, therefore, look to the trust instrument as it would be looked at by a New Jersey court for any such power to divert corpus. Appellant contends that a New Jersey court would find in it (1) an intention that the trustee prefer the life beneficiary, or (2) at least the absence of any legal inhibition on the trustee if it decided to do so. The intention that the trustee prefer the life beneficiary is inferred principally from the authorization in Article 9 of the trust to treat capital gain distributions from mutual funds as income.

In the context of this trust the inclusion of Article 9 is at best neutral on the issue of the settlor's intent. Because of the tax advantages referred to hereinabove many mutual funds pursue a policy of investing in securities which will result in capital appreciation rather than in income to the fund. Investment in such funds, if the capital gains distributions were to be treated as additions to

corpus, could have the effect of depriving the life beneficiary of income which other investments might have produced. Thus to the extent that the scrivener's handiwork actually reflects the settlor's intention, it reflects as much an intention to protect the life beneficiary from reduction of income for the benefit of the remainderman as an intention to prefer the former over the latter. Rather than creating a power to divert from one class to another the language is consistent with the neutral role which in New Jersey is required of trustees for successive interests. See, *e.g., In re Koretsky's Estate,* 8 N.J. 506, 86 A.2d 238 (1951); *Pennsylvania Co. For Lives and Granting Annuities* v. *Gillmore,* 137 N.J. Eq. 51, 43 A.2d 667 (Ch. 1945).

Of course the dispositive provisions of the trust authorize corpus invasions to provide for the support, maintenance and health needs of decedent's husband. That standard was found by the district court to be objectively determinable under New Jersey law, and the appellant does not on appeal contend that this finding is in error. It contends, however, that the courts of New Jersey would permit diversion to decedent's husband of sums beyond the objectively determinable standard. We do not agree.

> "A fiduciary is under a duty to act impartially as among the several beneficiaries or creditors of an estate or trust, and not to favor one over another, whether, as in the case of beneficiaries, their interests are concurrent or successive. Where the trustee is directed to pay income to a beneficiary for life with the corpus to another, he is under a duty to fairly adjust their conflicting investment interests." Clapp, *New Jersey Practice, Wills & Administration* (3d ed. 1962) §994.

Even where the provisions of a trust agreement clothe the actions of a New Jersey fiduciary with apparent finality he must stay within the bounds of a reasonable judgment in choosing between remaindermen and present beneficiaries. *Russell* v. *Princeton Laboratories, Inc.*, 50 N.J. 30, 38, 231 A.2d 800, 805 (1967). Absent a clear expression of intention by the settlor to the contrary[5] it is the duty of New Jersey trustees to deal impartially between successive beneficiaries. *In re Koretsky's Estate, supra.* In *Pennsylvania Co. for Lives and Granting Annuities* v. *Gillmore, supra* at 58, 43 A.2d at 672, the court expressed the trustee's duty thus:

> "The question before the Court must therefore be decided on the legal aspects and the question is, what is the duty of the trustee of this residuary trust? That duty, as laid down in the *Restatement of the Law of Trusts,* is 'to deal impartially' as between the successive beneficiaries, and to act 'with due regard to their respective interests.' To accomplish this result where, as in this case, the trustee is directed to pay income for life to one set of beneficiaries and at the end of that period to pay over the principal to the remaindermen, 'the trustee is under a duty' to the life tenants 'to take care not merely to preserve the trust property but to make it productive so that a reasonable income will be available for the life tenants,' and it is under a duty to the remaindermen to 'take care to preserve the trust property for them.' The trustee 'is not under a duty to the life tenants to endanger the safety of the principal in order to produce a larger

[5] Compare *In re Estate of Conway,* 50 N.J. 525, 236 A.2d 841 (1967).

> income,' but he is under a duty 'not to sacrifice income for the purpose of increasing the value of the principal.'"

The quotes within the quote are from Section 232 of the Restatement of Trusts (1935). The rule set forth is the settled law of New Jersey, and it is inconceivable that the courts of that state would permit a New Jersey trustee to pursue an investment policy designed to divert corpus from the remainderman to a life beneficiary. E.g., *Bliss* v. *Bliss*, 126 N.J. Eq. 308, 8 A.2d 705 (Ch. 1939). Particularly is this true of charitable remainders, for the protection of which the Attorney General of New Jersey is charged with special responsibilities. N.J.R.R. 4:28-4.

The provisions in the trust giving the trustee power to invade corpus to meet the life tenant's needs does not point to a different result. In the exercise of that dispositive provision a New Jersey trustee still must act as a fiduciary. The exercise of that power is limited by the life tenant's separate income. *Sibson* v. *First National Bank and Trust Co. of Paulsboro*, 64 N.J. Super. 225, 165 A.2d 800 (App. Div. 1960). A New Jersey court would not permit a trustee to circumvent his fiduciary duty to determine the life tenant's objective need by the subterfuge of making investments which would produce income and deplete corpus. By the same token a New Jersey court would not permit an investment policy which would eliminate a reasonable return in favor of capital appreciation for the remainderman. See *Commercial Trust Co.* v. *Barnard*, 27 N.J. 332, 142 A.2d 865 (1958).

Article 9 of the decedent's trust is consistent with this neutral policy. The trustee may invest in securities in which the incremental growth occurs from capital appreciation

rather than from income. If it does so, however, it must maintain a balance between the interests of the successive beneficiaries by allotting to the life beneficiary a part of the current incremental growth. If the trustee goes too far in that direction it will violate its fiduciary duty to the remainderman, and the courts will intervene. *Cf. Briel* v. *Moody,* 77 N.J. Super. 306, 186 A.2d 314 (Ch. 1962). Compare N.J. Rev. Stat. § 3A:14A-5(A)(d), enacted in 1964 in order to comply with the Commissioner's view expressed in Revenue Ruling 60-385.

We are aware that the Fifth Circuit, in two cases arising under Florida law, has accepted much of the position advanced here by the appellant with respect to clauses similar to Article 9. *The Florida Bank at Lakeland* v. *United States,* No. 30,183 (5 Cir. April 26, 1971); *The Miami Beach First National Bank* v. *United States,* No. 29,524 (5 Cir. April 30, 1971). The trust provisions in those cases are different than here, and the law of Florida, as set forth in those opinions, apparently differs from that of New Jersey.

Both the provisions of the trust instrument and the law of New Jersey present quite a different situation with respect to the trustee's powers than was presented in *Estate of Stewart* v. *Commissioner, supra.* Because there is not in this trust, as it would be construed in New Jersey, a power to divert the ascertainable corpus from its charitable purpose, Section 20.2055-2(b), the deduction should have been allowed. The judgment of the district court will be affirmed.

Appendix B

IN THE

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 19,032

PEOPLES TRUST COMPANY OF BERGEN COUNTY, EXECUTOR OF THE ESTATE OF DORA PLUME, *Deceased*,

Plaintiff-Appellee

v.

UNITED STATES OF AMERICA,

Defendant-Appellant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Appellant's Petition for Rehearing With Suggestion for Rehearing *En Banc*

To the Honorable United States Court of Appeals for the Third Circuit and the Honorable J. Cullen Ganey, Senior Judge, and Francis L. Van Dusen and John J. Gibbons, Circuit Judges thereof:

Pursuant to Rules 35(a)(1) and 40 of the Federal Rules of Appellate Procedure and Rule 2(3) of the Rules of this Court, the United States of America, appellant herein, respectfully petitions for a rehearing with a suggestion that it be heard en banc.

Appellant's Petition for Rehearing With Suggestion for Rehearing En Banc

1. The only issue in this appeal is whether the value of a charitable remainder bequest is presently ascertainable and, hence, deductible under Section 2055 of the Internal Revenue Code of 1954. In an opinion dated June 9, 1971, the Court held that the charitable remainder interest was ascertainable and affirmed the judgment of the District Court. In reaching this conclusion, the Court held that New Jersey trust law would prohibit decedent's trustee from exercising its administrative powers in such a fashion as to deplete the trust corpus and, thus, those powers did not render the remainder interest unascertainable.

This petition is filed in the view that the rationale underlying this decision is inconsistent with that upon which this Court founded its decision in *Estate of Stewart* v. *Commissioner*, 436 F. 2d 1281 (1971) (No. 17,802), petition for certiorari pending. It is respectfully submitted that the interests of clarity and consistency in this area of the tax law would be served by the Court's resolution of this inconsistency in its decisions.

2. The instant case concerns a trust under which decedent granted a life income interest to her husband and left the remainder interest to certain named charities, each of which was a qualified charitable recipient under Section 2055 of the Internal Revenue Code of 1954. (R. 3-4; Slip Op. 2.) The trustee of this charitable remainder trust was authorized to invest in any "* * * stocks * * * or securities of recognized investment rating * * *" (R. 13), an investment power which included the authority to invest in shares of mutual fund stock. New Jersey Statutes Annotated, §3A.15-17. Decedent further directed her trustee to distribute all capital gains dividends realized from mutual

fund investments to the non-charitable income beneficiary. (R. 13.) The Government argued that, because of the structure of mutual funds and the nature of tax incentives bearing upon these funds, this combination of investment authority and apportionment direction provided the trustee with a mechanism by which to deplete the trust corpus in favor of the income beneficiary. This mechanism may be illustrated as follows: Since the value of mutual fund stock is determined by the value of the assets held by the fund on the day of purchase (*Estate of Wells* v. *Commissioner*, 50 T.C. 871 (1968), aff'd sub. nom. 418 F. 2d 1302 (C.A. 6, 1969), cert. denied, 398 U.S. 950 (1970), rehearing denied, 400 U.S. 856 (1970)), the price paid may in part be attributable to unrealized capital gains in assets held by the fund. Subsequent to the trust's purchase of stock, the mutual fund may realize these gains and, in turn, distribute them to its shareholders as a capital gains distribution. Internal Revenue Code of 1954, Section 854 (b)(3). Such a distribution which, under the terms of the instant trust, *must* be distributed to the income beneficiary, reduces the value of the mutual fund shares held by the trust by the amount of the capital gains received by the trustee. (See our main brief, pp. 8-13.)

Under the well-settled construction of Section 2055 of the Internal Revenue Code of 1954 (*Henslee* v. *Union Planters Bank*, 335 U.S. 595 (1949), rehearing denied, 336 U.S. 915 (1949); *Merchants Bank* v. *Commissioner*, 320 U.S. 256 (1943); *Zentmayer's Estate* v. *Commissioner*, 336 F. 2d 488 (C.A. 3, 1964)), no deduction may be allowed for a charitable remainder bequest unless the amounts immune from the exercise of such an invasionary power may be accurately computed (*Estate of Stewart* v. *Commissioner*,

supra), a prerequisite to deduction which we urged the taxpayer could not meet. This Court, however, held that such amounts could be computed. It based this conclusion on its reading of the New Jersey fiduciary law which is applicable to decedent's trustee. Under the Court's interpretation of New Jersey law (Slip Op. 11):

> The trustee may invest in securities in which the incremental growth occurs from capital appreciation rather than from income. If it does so, however, it must maintain a balance between the interests of the successive beneficiaries by allotting to the life beneficiary a part of the current incremental growth. If the trustee goes too far in that direction it will violate its fiduciary duty to the remainderman, and the courts will intervene.

We respectfully submit that nothing in New Jersey law would operate to permit, much less require, the trustee to apportion a part of a mutual fund's capital gains distribution to trust corpus (see New Jersey Statutes Annotated, §3A:14A-2) and, further, that the Court's interpretation of New Jersey fiduciary law as providing a sufficient limitation on the trustee's powers of invasion is inconsistent with the Court's treatment of the essentially equivalent limitation imposed by New York law upon the *Stewart* trustee.

3. *Estate of Stewart* v. *Commissioner*, *supra*, involved a trust under which the trustee was granted the following powers (436 F. 2d, pp. 1283-1284):

> 4. The trustee shall have the following powers, authority, and discretion, which may exercise in its sole

and absolute discretion whenever and as often as it may deem advisable without application to or approval by any Court, namely:

To retain any property herewith or hereafter placed in trust, and to receive, invest in and retain stocks (whether common or preferred), bonds, securities, undivided interests in any real and personal property, shares or interests in investment companies or investment trusts, any Common Trust Fund maintained by the corporate trustee, and any property, real or personal, foreign or domestic, whether or not wasting assets, without any duty to diversify and without any restriction placed upon fiduciaries by any present or future applicable law, rule of court or court decision, and from time to time to hold property uninvested without liability for interest or loss of income. * * *

To apportion to principal or to income or in part to both any rents, dividends, interest or other income accrued or declared, but unpaid, in respect of any property at the time of the receipt of such property by the trustee, any dividend of whatever kind or nature, any property received upon any exchange, reorganization, recapitalization, consolidation, merger or dissolution, any rents, royalty or payment received in respect of any so-called "Wasting asset" or so-called "unproductive property" or any other receipt whatsoever, to determine whether or not to amortize in whole or in part the premium at which any property may be received or held or any depreciation on or any expense in connection with any property, real or personal, to discontinue any sinking fund or depreciation or depletion

reserve and to treat the same as income in whole or in part and to pay from principal or income or in part from both any deficit from the operation of any improved or unimproved property or any charge against the trust estate, to distribute property determined to be income and to hold property determined to be principal without liability to any person then or thereafter interested in the trust estate, upon the termination of any trust to pay any accrued rents, dividends, interest or other income, to the next estate without apportionment and in connection with the foregoing to follow or depart, in whole or in part, from any rule of law; provided that nothing herein shall authorize an illegal accumulation of income.

In all matters to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care.

12. This indenture shall be construed, regulated, and administered in all respects in accordance with the laws of the State of New York, except as otherwise herein expressly provided.

Rejecting an argument similar to that which forms the basis for the instant decision, the *Stewart* Court held that even though (436 F. 2d, p. 1288)——

> * * * the decedent's dispositive intent does not reveal any desire to favor the life tenants over the remaindermen, * * * decedent's administrative intent was to rely solely upon the trustee's judgment and discretion

rather than upon the normal rules of state law governing the administration of trusts. Such broad powers have been previously recognized as enabling a trustee, acting safely within his prerogatives, to shift "very substantially . . . the economic benefits of the trusts between the life tenants and the remaindermen," *State Street Trust Co.* v. *United States*, 263 F. 2d 635, 369 (1st Cir. 1959). Although the First Circuit in *Old Colony Trust Co.* v. *United States*, 423 F. 2d 601 (1970) has recently qualified the *State Street Trust* decision as it applies to Massachusetts law, the statement quoted nonetheless remains correct with respect to New York law. The doctrine of *In re Talbot's Will, supra*, and *In re Estate of Lecompte, supra* (a trustee must always satisfy the court that the allocation was in fact prudent, if it [is] challenged") does not provide the requisite ascertainable standard for amounts left to charity where the powers are so broad as here. (Footnotes omitted.)

4. While the powers granted the *Stewart* trustee were different from those granted this trustee and may, as the Court here intimated (Slip Op. 4-5), have been more invasionary in nature, the manner in which the Court here reached its decision does not hinge on those differences. Instead, the instant decision turns only on the New Jersey doctrines of fiduciary law which, absent a "clear expression" of an intention to favor the life beneficiary (Slip Op. 9), were read as voiding the trustee's discretionary power to deplete corpus. We submit that if New York's fiduciary law did not limit the *Stewart* trustee's invasionary powers so as to satisfy the requirements of Section 2055, New

Jersey law must equally be insufficient to satisfy the requirements of that section. The laws of these two states are based upon essentially the same equitable principles. Thus, while New York trustees must satisfy New York courts that exercises of discretion were "prudent" (*Estate of Stewart* v. *Commissioner, supra,* p. 1288; *In re Talbot's Will,* 170 Misc. 138, 9 N.Y.S. 2d 806 (Surr., 1939)), New Jersey trustees are, at most, bound by the no more demanding standard of proving their discretionary powers were exercised "within the bounds of a reasonable judgment." (Slip Op. 9.) *Russell* v. *Princeton Laboratories, Inc.,* 50 N.J. 30, 38, 231 Atl. 2d 800, 805 (1967).* The decedent here, as did the decedent in *Stewart,* conferred discretionary powers upon her trustee. The New Jersey courts, of course, retain the ultimate power to intervene should a trustee *abuse* the discretion granted it, but the measure of deviation from normal trust practice required to establish an abuse of discretion is, in New Jersey as well as in New York, substantial. Compare, *Swetland* v. *Swetland,* 100 N.J. Eq. 196, 134 Atl. 822 (Ch., 1926), with *In re Estate of Davis,* 54 Misc. 2d 1065, 284 N.Y.S. 2d 414 (Surr. Ct., 1967); see also III Scott, *Trusts,* §187 (1967). (See our main brief, pp. 14-16.) To be sure, there is some outer limit beyond which the trustee here cannot go without encountering judicial intervention. *Pennsylvania Co., Inc.* v. *Gillmore,* 137 N.J. Eq. 51, 43 A. 2d 667 (Ch., 1945) (change of investments which would reduce life beneficiaries' income by over 21 to 68 percent not permissible). But, as the *Stewart* court clearly

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* The court in this case was, of course, dealing with trustees whose personal interests conflicted with those of the beneficiary. The outcome of the case, we suggest, may in part reflect the court's awareness of that conflict. III Scott, *Trusts,* §187 (1967).

held, the protections afforded by the potential of state court intervention is alone insufficient to "guarantee preservation of any predictable fraction of corpus for disposition" to the charitable remaindermen. *Henslee* v. *Union Planters Bank, supra,* pp. 598-599, fn. 3. The mere fact that the two trustees may be held accountable to courts of different states, provides no adequate basis for the difference in outcome when these courts apply the same standards to review exercises of discretionary powers.

Respectfully submitted,

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June 1971.

Appendix C

INTERNAL REVENUE SERVICE

CHIEF COUNSEL LIST OF PENDING CASES PAGE 1791 MAY 1971

Issue Number	*Counsel Office*	*Groups	*Court*	*Name of Taxpayer*	*Date of Origin*	*Docket Number*
2055.03-03	PRESENTLY ASCERTAINABLE CHARITABLE REMAINDER					
	TAX COURT DIV	*	3 CIR	STEWART L M 436 F2D1281	02-68	689-68
	REF LIT DIV	*	9 CIR	GARDINER M J	10-65	
		*	3 CIR	PEOPLES TRUST COMPANY	09-67	
		*	ED PA	DILWORTH REBA R	02-68	
		*	5 CIR	MIAMI BEACH FIRST NAT	05-68	
		*	5 CIR	FLORIDA NATIONAL BANK	06-68	
		*	ED PA	PROVIDENT NATIONAL BANK	06-69	
		*	6 CIR	LOYD DOROTHY	06-69	
		*	S OHIO	TOULMIN HARRY A	07-69	
		*	CONN	HARTFORD NATIONAL BANK	08-69	
		*	COLO	COLORADO NATIONAL BANK	09-69	
		*	ND TEX	DOSS MEEK LANE	11-69	
		*	SD ILL	BURROUGHS GORDON	01-70	
		*	ND ILL	RAIDER ELEANORE K	03-70	
		*	E MICH	DETROIT BANK & TRUST	05-70	
		*	COLO	AMERICAN NATIONAL	08-70	
		*	MD	MERCANTILE-SAFE DEPOSIT	10-70	
		*	NEBR	FIRST NATIONAL BANK	10-70	
		*	SD NY	JOHNSTON OSWALD L	10-70	
		*	SD ILL	MILLIKIN NATIONAL	11-70	
		*	R I	INDUSTRIAL NATIONAL BANK	12-70	
	BOSTON	*	TAX CT	BUNKER MARGARET P	09-70	5798-70
		*	TAX CT	ETTLINGER EVA	09-70	5956-70
		*	TAX CT	LANCASTER SOUTHWORTH	02-71	838-71
	BUFFALO	*	TAX CT	SAUER LEO	02-71	773-71
	NEW YORK CITY	*	TAX CT	JAECKER HARRY C	02-69	824-69

Appendix C (Cont'd)

INTERNAL REVENUE SERVICE

CHIEF COUNSEL LIST OF PENDING CASES PAGE 1792 MAY 1971

Issue Number	*Counsel Office*	*Groups	*Court*	*Name of Taxpayer*	*Date of Origin*	*Docket Number*
2055.03-03	PRESENTLY ASCERTAINABLE CHARITABLE REMAINDER					
		*	TAX CT	IGNATINSKY BERTHA	05-69	2055-69
		*	TAX CT	MAIR WILLIAM J	01-70	238-70
		*	TAX CT	CLAY CHARLES M	06-70	3170-70
		*	TAX CT	LAMSON LOUISE N	11-70	6974-70
	PHILADELPHIA	*	TAX CT	SPEER GEORGE I	07-69	3346-69
		*	TAX CT	GROH IDA CASTER	11-70	6907-70
		*	TAX CT	JOHNSON EMILY COOPER	12-70	7683-70
	WASHINGTON	*	TAX CT	GEIGER MARGARET MAY	12-68	6039-68
		*	TAX CT	GRISWOLD ROGER W	08-70	5091-70
	ATLANTA	*	TAX CT	BALDWIN LOUVINE M	12-70	7794-70
	JACKSONVILLE	*	TAX CT	EVANS IRVING	06-70	3442-70
		*	TAX CT	BALCH BESS D	04-71	2379-71
	CLEVELAND	*	TAX CT	REED MARTHA STECHER	04-69	1855-69
	CHICAGO	*	TAX CT	BREAULT OSCAR J EST	06-64	3022-64
		*	TAX CT	FEIGENHOLTZ H L TRANSF	09-64	4963-64
		*	TAX CT	FEIGENHOLTZ ET AL TRANSF	09-64	4964-64
	OMAHA	*	TAX CT	OBRIEN RICHARD F	02-70	733-70
		*	TAX CT	FALK PEARL H	07-70	4351-70
	LOS ANGELES	*	TAX CT	MATSON ESTATE ESTHER	07-70	4829-70
		*	TAX CT	KIME MABEL N	12-70	7645-70
	PHOENIX	*	TAX CT	WALDRON GERALD B	12-68	6012-68
	SALT LAKE CITY	*	TAX CT	KALLAS JAMES	09-70	5667-70
	GROUPS 46		CASES 48			